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Tortoise QuickTake Podcast

September 12, 2017

Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, a senior member of Tortoise provides a timely update on trending topics in the market.

Hello and welcome to the Tortoise Credit Strategies weekly podcast. I'm Greg Haendel, one of the Senior Portfolio Managers on the investment team at Tortoise Credit Strategies.

First and foremost, our hearts, thoughts, and prayers go out to everyone in Texas, Florida, The Caribbean, and elsewhere that's been affected by Hurricane Harvey and Hurricane Irma.

The 1950's game entitled "Kick the Can" refers to a children's game whereby the child chosen to be "it" tags or captures players and puts them in a holding area near the can. The game is over when the child that is "it" captures all the other children. However, if one of the free players sneaks up and kicks the can, the captured children are released. The name of this game has morphed into the saying often repeated today, "kick the can down the road," meaning to procrastinate or put off solving a problem until later. The term, "kick the can down the road," can be best used to describe some of the recent actions out of the U.S. government when dealing with the debt ceiling, Federal Reserve policy and staffing and even ECB policy. In today's podcast, we will discuss some of the proverbial cans that have been kicked down the road this past week and their implications.

The U.S. is expected to reach its current $19.8 trillion legislatively set debt limit sometime in early to mid-October and without creative financing solutions from the U.S. Treasury Department, which only would provide a temporary delay, we would expect a temporary government shutdown, payment prioritization, or worst case scenario a technical default on our debt. We have witnessed several episodes of political wrangling in Washington D.C. as we have approached debt ceiling debates in the past, including 2011, 2013 and 2015 to name a few with the most severe resulting in a temporary partial government shutdown in October 2013.

Dealing with the debt ceiling is a necessity, although there is a good reason for the can to be kicked down the road this time around. Specifically, this past week President Trump and a majority of Congress agreed to a continuing resolution to suspend the debt ceiling until December 8th, fund the government, and most importantly provide hurricane relief aid. Given the dire and immediate needs of those in hurricane affected areas such as Texas, Florida and the Caribbean, a partial government shutdown, depletion of funds for FEMA, or lack of general relief aid from the government would have been catastrophic. While we applaud the efforts of our politicians working together in a bipartisan manner during a time of crisis, kicking this can down the road to December can and will create additional issues.

By kicking the budget and debt ceiling can down the road to December, we now face a showdown amongst politicians as we head into the holiday season with another threat of a potential government shutdown looming. In fairness, there has been speculation that the U.S. Treasury Department has some creative financing options that could delay a shutdown a couple of months, bringing "D Day" to sometime in the first or second quarter of 2018. The risk with leaving the debt ceiling issue looming much longer is it could distract Congressional focus away from achieving other important legislative agenda items, such as tax reform. If this distraction takes too long and isn't dealt with by the end of the year or early in Q1 2018, Congressional focus will likely turn toward the midterm elections by Q2 2018 thereby making most substantial policy initiatives very difficult to achieve until after the midterm elections. We believe the threat of a government shutdown or technical default are extremely low. However, substantial delays in President Trump's tax reform plan could have a negative impact on equity valuations, credit spreads and even push U.S. Treasury rates lower, all other things equal, as the positive boost to all the aforementioned post the election last year would get priced back out of the markets.

Another proverbial can being kicked down the road would be the removal of extraordinary monetary policy stimulus from both the Federal Reserve (The Fed) and the European Central Bank (The ECB). Several Fed officials, such as Lael Brainard and Neel Kashkari, expressed concern last week over a lack of inflation. This in turn could further delay the Fed from increasing the Federal Funds Target Rate more this year and could even cause the Fed to delay their balance sheet tapering

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announcement expected on September 20th. In fact, on Sept. 8th, 2017, Fed Funds futures had priced in a probability of only a 27% chance that the Fed would hike rates one more time this year versus approximately a 40% probability immediately following the July Fed meeting.

Further complicating the situation for the Federal Reserve has been uncertainty regarding who will be directing and influencing the Federal Open Market Committee in 2018. There has been a significant amount of speculation that Federal Reserve Chairman Janet Yellen would be replaced in early 2018 by White House Economic Advisor Gary Cohn. It was reported this past week that Cohen's relationship with President Trump has allegedly become strained and he would not be Yellen's successor. In addition, Fed Vice Chairman Stanley Fischer announced his resignation last week, effective mid-October. Although Fischer's four-year term was set to expire in June 2018, his surprise decision to resign early puts immediate pressure on the Trump Administration to replace vacating members of the Federal Reserve Board of Governors. In fact, Fischer's resignation leaves only three people in the seven board seats, resulting in the smallest number of occupied seats in Fed history. In turn, this adds both to the near term issues the Trump Administration must address, again potentially delaying other policy initiatives, as well as increases the uncertainty over the leadership and direction of U.S. monetary policy in 2018 and beyond.

The ECB further kicked yet another can down the road when they met this past week regarding monetary policy. Despite improving growth in the European region and despite the Centrals Banks' foot firmly on the gas pedal, they delivered no change in monetary policy and provided scant details on the likelihood of changes in the near term. This in turn helped cause a move lower in yields in several European government bonds, such as the 10-year German Bund.

In sum, the proverbial can keeps being kicked down the road in both the U.S. and Europe thereby causing policy uncertainty and helping to fuel lower interest rates in both the U.S. and Europe as well as some softness in risk assets in general. Our base case forecast remains higher interest rates in the intermediate to longer term given better economic growth going forward, eventual global monetary tightening and gradually rising inflation expectations. However, in the short-term, policy uncertainty could pressure interest rates lower while lower interest rates will likely pressure credit spreads wider, despite a continuation of easy monetary policy.

Thank you for listening to the Tortoise Credit Strategies podcast and hopefully you will join us for next week's edition.

Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at info@tortoiseinvest.com.

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